STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
JOSEPH DIGIROLOMO AND LEONARD OLIVA	:	DETERMINATION DTA NOS. 822420 AND 822421
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2003 through August 31, 2006.	:	

Petitioners, Joseph DiGirolomo and Leonard Oliva, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2003 through August 31, 2006.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 633 Third Avenue, New York, New York, on June 23, 2009 at 10:30 A.M., with all briefs to be submitted by December 20, 2009, which date began the six-month period for the issuance of this determination. Petitioners appeared by Alfred DiGirolomo, Jr., Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Sarah Dasenbrock, Esq., of counsel).

ISSUES

I. Whether petitioners, as officers of JJM-63 Restaurant Corporation (JJM), were responsible for the collection and payment of sales and use taxes on behalf of JJM for the period March 1, 2003 through August 31, 2006 (the audit period).

II. Whether the Division of Taxation properly determined additional sales and use taxes due from JJM for the audit period based upon an estimated audit methodology.

III. Whether petitioners have demonstrated reasonable cause for the abatement of penalty.

IV. Whether the Division of Tax Appeals had jurisdiction to hear this matter.

FINDINGS OF FACT

1. JJM operated a restaurant in Commack, New York, known as Ciao Baby during the period in issue, making taxable sales of food and beverages.

2. In February of 2006, the Division of Taxation (Division) initiated a field audit of JJM by mailing it an appointment letter, dated February 10, 2006, which requested all books and records of the corporation for the period March 1, 2003 through November 30, 2005 with regard to its sales and use tax liability. The letter included a records requested list, which requested, among other items, the following: sales tax returns; federal income tax returns; general ledger; general journal and closing entries; sales invoices; exemption documentation; chart of accounts; expense purchase invoices; bank statements; canceled checks; deposit slips; cash receipts journal; cash disbursement journal; financial statements; depreciation schedules; copies of leases; guest checks and cash register tapes; and the SLA license.

3. The Division later extended the audit period upon notice to JJM to include the period March 1, 2003 through August 31, 2006 and made a second request for all the books and records of the corporation, including those listed above, for the entire audit period.

4. On March 16, 2006, the auditor met with the representative of JJM and received incomplete bank statements, check stubs, federal income tax returns, incomplete daily sales sheets and sales tax returns. No guest checks, register tapes or other source documentation were

provided.[1] The representative provided a power of attorney and sales tax examination questionnaire signed by petitioner Joseph DiGirolomo.

5. After reviewing the documentation provided, the auditor determined that it was not sufficient for a detailed audit and decided that an estimated audit methodology would be necessary. The decision was supported by several discoveries. Sales records were deemed inadequate because there was no source documentation that could be traced to a source. In addition, sales accounting records were not in auditable condition.

Furthermore, gross sales were not found to be in substantial agreement with the sales reported on the federal income tax returns; nor were gross sales in agreement with sales reported on the sales tax returns. In both instances, the gross sales were in excess of sales reported on the federal and sales tax returns.

A review of the bank deposits revealed that the deposits were not in substantial agreement with the books and records, and indicated that the deposits were higher than supported by the records of the business.

Petitioner's representative was informed by telephone on March 28, 2006 that the auditor would utilize a markup audit to determine JJM's sales and use tax liability.

6. During the period between April 2006 and October 2006, the Division conducted two observations of JJM's bar operations and analyzed all facets of the bar sales and supply purchases. The beverage purchase information and daily sales sheets produced a food to beverage sales ratio of 69.2 to 30.8. Then, using drink size and price information, beverage sales were determined. Using the ratio, food sales were determined and the applicable tax rate was applied to total

[1]At a later date, some beverage invoices were provided.

beverage and food sales, yielding the tax due. This was for the original audit period of March 1, 2003 through November 30, 2005.

7. After a disagreement on drink sizes, the correlation between food and beverage purchases, a subsequent observation and further discussion with regard to the size of glassware, the Division decided to pursue a new audit methodology. A full observation of the restaurant was conducted on November 3, 2006 which determined the cash and credit card purchases for that day to be 54.10% cash and 45.90% credit card for total receipts. Since an evaluation of the sales from the observation on November 3, 2006, revealed that the percentage of credit card receipts for that day was much lower than the credit card deposits related to taxable sales for the audit period, it was apparent to the Division that cash sales were underreported.

8. An analysis of bank statements indicated that credit card fees had been deducted from settlements and so they were therefore added back by the auditor to reflect total credit card receipts. The auditor also removed credit card tips from the credit card receipts, leaving total credit card sales for the period March 1, 2003 through August 31, 2006 of $5,873,153.86. When this figure was divided by the credit card ratio (.4590) determined from the November 3, 2006 observation, it resulted in audited total receipts of $12,795,542.16. Receipts were then divided by the tax rate to arrive at taxable sales of $11,772,599.13. After allowing for reported taxable sales of $6,059,319.00, additional taxable sales were $5,713,280.13, resulting in additional sales and use taxes of $496,302.78.

9. A review of expense purchases records, which were found to be adequate for a detailed audit and in auditable condition, revealed taxable expense purchases of $500.48 on which tax of $43.61 was owed.

10. The Division issued a Notice of Determination to JJM, dated May 24, 2007, which asserted additional sales and use tax of $496,346.39 plus penalty and interest.

11. During the audit period, or at least for the period December 1, 2003 through August 31, 2006, petitioners, Joseph DiGirolomo and Leonard Oliva, were officers of JJM. Mr. DiGirolomo was the president and Mr. Oliva was the secretary. According to the responsible person questionnaires, dated December 20, 2006, submitted by their representative, Mr. David Wolfson, they both participated in making significant business decisions; maintained and managed the business operations of JJM; owned corporate stock; derived substantial income from the business; and had authority to manage the business affairs of the company, pay creditors, sign checks, execute legal documents on behalf of the business, hire and fire employees, and negotiate and guarantee loans for the company. Mr. DiGirolomo's address was listed by his representative as 15 Bethel Lane, Commack, New York. Mr. Oliva's address was listed by his representative as 11 Glen Way, Cold Spring Harbor, New York.

12. The Division issued to Joseph DiGirolomo at the address supplied by Mr. Wolfson in the responsible person questionnaire, a Notice of Determination, dated May 25, 2007, which asserted additional sales and use taxes due on behalf of JJM in the sum of $387,513.65 plus penalty and interest for the period December 1, 2003 through August 31, 2006.

13. The Division issued to Leonard Oliva at the address supplied by Mr. Wolfson in the responsible person questionnaire, a Notice of Determination, dated May 25, 2007, which asserted additional sales and use taxes due on behalf of JJM in the sum of $387,513.65 plus penalty and interest for the period December 1, 2003 through August 31, 2006.

14. The affidavits of Patricia Finn Sears, one for each petitioner, sworn to July 13, 2009, set forth the Division's general practice and procedure for processing statutory notices. Ms. Sears

received from CARTS the computer-generated CMR and the corresponding notices. Here, page 8 of the 14-page CMR contained information on the notices in issue. Taxpayer addresses, certified control numbers, and reference numbers assigned to each notice may be found under their respective columns on the CMR. The reference number and control number appear on the corresponding notice and accompanying cover sheet, respectively, while the address appears on both. Page 8 of the CMR established that a notice with the control number 7104 1002 9730 0059 6417 and reference number L-028624612 was sent to petitioner Joseph DiGirolomo at 15 Bethel Lane, Commack, New York 11725-1003. Also on page 8 of the CMR, it was stated that a notice with the control number 7104 1002 9730 0059 6400 and reference number L-028624613 was sent to petitioner Leonard Oliva at 11 Glen Way, Cold Spring Harbor, New York 11724-1803. A United States postmark on each of the 14 pages of the CMR, including page 8 containing the names of petitioners, confirmed that the notices of determination in issue were sent to petitioners on May 25, 2007.

Ms. Sears specifically stated that the procedures described and followed were the normal and regular procedures in effect as of May 25, 2007.

15. The affidavits of James Steven VanDerZee, one for each petitioner, sworn to July 15, 2009, described the Mail Processing Center's general operations and procedures. The Center received the notices and placed them in an "Outgoing Certified Mail" area. A mailing cover sheet preceded each notice. A staff member retrieved the notices and operated a machine that put each notice into a windowed envelope. Staff members then weighed, sealed and placed postage on each envelope. A mail processing clerk then checked the first and last pieces of certified mail listed on the CMR against the information contained on the CMR and then performed a random review of up to 30 pieces of certified mail listed on the CMR by checking those envelopes against

the information contained on the CMR. A staff member then delivered the envelopes and the CMR to one of the various U.S. Postal Service (USPS) branches located in the Albany, New York, area. A USPS employee affixed a postmark and also placed his or her signature or initials on the CMR, indicating receipt by the post office. A review of pages 1, 8 and 14 of the CMR submitted by the Division confirmed that a USPS employee marked said pages of the CMR with the USPS postmark and placed his initials on each page. Page 8 contained the mailing to both petitioners. The USPS postmark is from the "Colonie Center 12205" mail facility and bears the date May 25, 2007, confirming that the notices were mailed on that date.

16. By orders, dated April 25, 2008, the Bureau of Conciliation and Mediation Services (BCMS) sustained the notices of determination issued to petitioners.

SUMMARY OF PETITIONERS' POSITION

17. Petitioners disagreed with the Division's finding with respect to the credit card ratio, and contended that credit card sales were more typically closer to 80%. Petitioners argued that the day chosen for the observation, November 3, 2006, was a Friday and many of the "blue collar" patrons get paid on Fridays, thus accounting for the inordinate number of cash sales. To support this contention, petitioners submitted daily sales sheets for the month of December 2006.

18. Petitioners raised the jurisdictional issue of proper issuance of the notices in their hearing memorandum for the first time. At hearing, their representative claimed that the notices had not been received by petitioners and that the Division of Tax Appeals lacked jurisdiction to hear this matter.

19. The Division's analysis of the daily sales sheets for the month of December 2006 revealed that the cash sales for JJM were consistently about 20% every day of operation. Thus, argues the Division, only the credit cards were being reported accurately on the sheets.

20. The Division asserts that the notices were properly issued to petitioners and that there was a presumption that they were received and that the Division of Tax Appeals has jurisdiction to hear this matter.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "a sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed was incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices. . . ." (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.,*** Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of Your Own Choice, Inc***. as follows:

> To determine the adequacy of a taxpayer's records, the Division must first request ***(Matter of Christ Cella, Inc. v. State Tax Commn.***, [102 AD2d 352, 477 NYS2d 858] ***supra***) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (***Matter of Adamides v. Chu***, 134 AD2d 776, 521 NYS2d 826, ***lv denied*** 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726, 535 NYS2d 255; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***see also***, ***Matter of Hennekens v.***

State Tax Commn., 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (***Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43; ***Matter of Christ Cella, Inc. v. State Tax Commn.***, ***supra***), "from which the exact amount of tax due can be determined" (***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***Matter of Urban Liqs. v. State Tax Commn.***, ***supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Cousins Serv. Station***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

C. In this matter, the Division made a proper request for petitioners' books and records, most of which were never supplied by JJM or petitioners. The auditor was left without the material needed to do a detailed audit and was justified in resorting to an estimated audit methodology to determine petitioner's tax liability for the audit period (***Matter of Urban Liqs. v. State Tax Commn.***).

D. The Division's use of a one-day observation test and available records of JJM was a reasonable audit methodology (***Matter of Oggi Restaurant, Inc.***, Tax Appeals Tribunal, November 30, 1990) and extrapolation of the results of a one-day test over a multi-year audit period was reasonable also (***Matter of Del's Mini Deli, Inc. v. Commr of Taxation and Finance***, 205 AD2d 989, 613 NYS2d 967 [1994]). The specific methodology employed by the

Division in this matter was reasonably calculated to reflect taxes due because it utilized JJM's bank records, credit card deposits and the results of a full day's observation of sales.

Petitioners bore the burden of proving with clear and convincing evidence that the assessment was erroneous or that the audit methodology was unreasonable. They did not. Their only defense was that the credit card ratio was incorrect, a contention they failed to support with any credible evidence. Having failed to carry their burden, it is determined that the audit methodology was valid and its results reasonable. (***Matter of Scarpulla v. State Tax Commn***.)

E. Tax Law § 1133(a) imposes upon any person required to collect the tax imposed by Article 28 of the Tax Law personal liability for the tax imposed, collected or required to be collected. A person required to collect tax is defined to include, among others, corporate officers and employees who are under a duty to act for such corporation in complying with the requirements of Article 28 (Tax Law § 1131[1]).

Generally, the resolution of whether a person is responsible to collect and remit sales tax for a corporation so that the person would have personal liability for the taxes not collected or paid depends on the facts of each case (***Matter of Cohen v. State Tax Commn.,*** 128 AD2d 1022, 513 NYS2d 564 [1987]; ***Stacy v. State Tax Commn.,*** 82 Misc 2d 181, 183, 368 NYS2d 448 [1975]).

In ***Matter of Vogel v. Department of Taxation and Finance*** (98 Misc 2d 222, 413 NYS2d 862, 865 [1979]), the court stated:

> The general language of section 1131 (subd. 1), defining persons who are required to collect taxes, includes only those officers of a corporation who are 'under a duty to act for such corporation.' The resolution of whether an officer is under a duty to act, then, turns on a factual determination.
>
> Indicia of this duty would include factors which directly relate to compliance with Article 28, such as the officer's day-to-day responsibilities and involvement,

> with the financial affairs and management of the corporation, his knowledge of such matters, the officer's duties and functions outlined in the certificate of incorporation and the bylaws, and the preparation and filing of sales tax forms and returns. Furthermore, in situations involving closely held corporations, as in the present case, an officer's knowledge of the corporate affairs and his benefits received from corporate profits would be extremely important considerations. (Citations omitted.)

Indeed, the Division's own regulations define a person under a duty to act on behalf of a corporation as follows:

> [g]enerally, a person who is authorized to sign a corporation's tax returns or who is responsible for maintaining the corporate books, or who is responsible for the corporation's management, is under a duty to act. (20 NYCRR 526.11[b][2].)

In this matter, the facts support a finding of petitioners' personal responsibility for the tax liability of JJM, because they each possessed many of the indicia set forth in the case law and the regulations, and more fully described in their responsible person questionnaires.

In addition, the failure to appear at the hearing, although not mandatory, certainly exhibits conduct which can only be interpreted as evasive, since petitioners had full knowledge of the business operations of JJM yet chose not to divulge it at hearing, and credit sales, drink sizes and cash transactions on particular days of the week were presumably seen regularly in the scope of their duties. Choosing not to testify must be construed against them, since, like any missing witnesses, it may reasonably be inferred that their testimony would not have been favorable to their claims. (***See Matter of Meixsell v. Commissioner of Taxation***, 240 AD2d 860, 659 NYS2d 325 [1997], ***lv denied*** 91 NY2d 811, 671 NYS2d 714 [1998].)

F. Petitioners' claim that they did not receive the notices is rejected as is their assertion that the Division of Tax Appeals lacks jurisdiction in this matter. After petitioners raised this issue of nonreceipt in their hearing memorandum and again at hearing, the Division provided proof that the notices of determination, dated May 25, 2007, were in fact sent to them by certified

mail on that day to the addresses they provided to the Division in the responsible person questionnaires on December 20, 2006.

The "presumption of delivery" does not arise unless or until sufficient evidence of mailing has been produced and the burden of demonstrating proper mailing rests with the Division (***Matter of Novar TV & Air Conditioning Sales & Serv.***, Tax Appeals Tribunal, May 23, 1991).

The evidence required of the Division in order to establish proper mailing is two-fold: first, there must be proof of a standard procedure used by the Division for the issuance of notices by one with knowledge of the relevant procedures; and, second, there must be proof that the standard procedure was followed in this particular instance (***see Matter of Katz***, Tax Appeals Tribunal, November 14, 1991**;** ***Matter of Novar TV & Air Conditioning Sales & Serv.***). The Sears and VanDerZee affidavits, along with the postmarked CMR satisfied these requirements and established that the notices were properly mailed to petitioners on May 25, 2007 at the addresses provided to the Division by their representative in the responsible person questionnaires, dated December 20, 2006. Thus, there was a valid presumption of delivery.

G. Tax Law § 1145(a)(1)(i) authorizes the imposition of a penalty for the failure to file a return or to pay or pay over the sales and use tax due within the time required. Tax Law § 1145(a)(1)(vi) authorizes the imposition of a penalty upon a taxpayer for his omission from the total amount of sales and use taxes required to be shown on a return an amount which is in excess of 25 percent of the amount of such taxes required to be shown on the return. Such penalties may be abated, pursuant to Tax Law § 1145(a)(1)(iii) and (vi), when the taxpayer establishes that such omission was due to reasonable cause and not due to willful neglect. Reasonable cause includes any cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause for the delay in filing a sales tax return and paying

the tax imposed under Articles 28 and 29 of the Tax Law (***see*** 20 NYCRR 2392.1[d][5]). Petitioners have not presented any evidence or argument warranting waiver of the penalties asserted.

H. The petitions of Joseph DiGirolomo and Leonard Oliva are denied and the notices of determination, dated May 25, 2007, are sustained.

DATED: Troy, New York
June 17, 2010

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE